

INGLES MARKETS INC  
Form 10-Q/A  
February 10, 2005  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q/A**

Amendment No. 1

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x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 27, 2004

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-14706.

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**INGLES MARKETS, INCORPORATED**

(Exact name of registrant as specified in its charter)

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<b>North Carolina</b> (State or other jurisdiction of incorporation or organization)	<b>56-0846267</b> (I.R.S. Employer Identification No.)
<b>P.O. Box 6676, Asheville NC</b> (Address of principal executive offices)	<b>28816</b> (Zip Code)

**(828) 669-2941**  
Registrant's telephone number, including area code

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No .

As of April 30, 2004, the Registrant had 11,241,896 shares of Class A Common Stock, \$0.05 par value per share, outstanding and 12,369,841 shares of Class B Common Stock, \$0.05 par value per share, outstanding.

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**EXPLANATORY NOTE**

Ingles Markets, Incorporated ( Ingles or the Company ) is filing this Quarterly Report on Form 10-Q/A (the Form 10-Q/A ) for the quarter ended March 27, 2004 to reflect the restatement of its consolidated financial statements, the notes thereto, and related disclosures.

During preparation for its annual audit and annual report on Form 10-K for fiscal 2004 and as a result of a previously announced internal investigation initiated after an informal Securities and Exchange Commission inquiry, the Company determined that certain vendor allowances and certain other revenue and expense items were accounted for incorrectly. In addition, the Company identified accounting errors related to certain lease transactions. Ingles is filing this Form 10-Q/A for purposes of restating its consolidated financial statements for the periods ended March 27, 2004 and March 29, 2003 in order to correct these errors. The adjustments made to Ingles' financial statements are further described in Note B to the consolidated financial statements.

This Form 10-Q/A has not been updated except as required to reflect the effects of the restatement. This amendment and restatement includes changes to Part I, Items 1, 2 and 4 and Part II, Item 6. Except as identified in the prior sentence, no other item included in the original Form 10-Q has been amended, and such items shall remain in effect as of the filing date of the original Form 10-Q. Additionally, this Form 10-Q/A does not purport to provide an update or discussion of any other developments at the Company subsequent to its original filing.

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Part I. Financial Information

**Item 1. Financial Statements**

**INGLES MARKETS, INCORPORATED AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

**ASSETS**

	<b>MARCH 27, 2004 (RESTATED)</b>	<b>SEPTEMBER 27, 2003 (RESTATED)</b>
Current Assets:		
Cash and Cash Equivalents	\$ 44,209,311	\$ 80,879,318
Receivables	31,573,431	34,220,658
Inventories	186,825,769	193,402,781
Other Current Assets	12,708,790	11,768,169
Total Current Assets	275,317,301	320,270,926
Property and Equipment Net	752,717,199	739,023,467
Other Assets	14,669,313	16,155,680
Total Assets	\$ 1,042,703,813	\$ 1,075,450,073

See notes to unaudited interim financial statements.

**Table of Contents****INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

## LIABILITIES AND STOCKHOLDERS' EQUITY

	MARCH 27, 2004 (RESTATED)	SEPTEMBER 27, 2003 (RESTATED)
<b>Current Liabilities:</b>		
Short-term loans and current portion of long-term debt	\$ 31,190,903	\$ 38,032,125
Accounts payable, accrued expenses and current portion of other long-term liabilities	129,113,982	149,627,349
<b>Total Current Liabilities</b>	<b>160,304,885</b>	187,659,474
Deferred Income Taxes	41,503,578	39,663,578
Long-Term Debt	588,858,006	602,932,198
Other Long-Term Liabilities	7,542,947	8,599,709
<b>Total Liabilities</b>	<b>798,209,416</b>	838,854,959
<b>Stockholders' Equity</b>		
Preferred stock, \$0.05 par value; 10,000,000 shares authorized; no shares issued		
<b>Common stocks:</b>		
Class A, \$0.05 par value; 150,000,000 shares authorized; 11,204,274 shares issued and outstanding March 27, 2004; 10,635,419 shares issued and outstanding September 27, 2003	560,213	531,770
Class B, \$0.05 par value; 100,000,000 shares authorized; 12,369,841 shares issued and outstanding March 27, 2004; 12,391,216 shares issued and outstanding September 27, 2003	618,492	619,561
Paid-in capital in excess of par value	107,935,237	102,465,443
Retained earnings	135,380,455	132,978,340
<b>Total Stockholders' Equity</b>	<b>244,494,397</b>	236,595,114
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 1,042,703,813</b>	\$ 1,075,450,073

See notes to unaudited interim financial statements.

**Table of Contents****INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

	<b>THREE MONTHS ENDED</b>	
	<b>MARCH 27, 2004 (RESTATED)</b>	<b>MARCH 29, 2003 (RESTATED)</b>
Net sales	<b>\$ 520,792,146</b>	\$ 489,382,957
Cost of goods sold	<b>383,611,145</b>	360,976,562
Gross profit	<b>137,181,001</b>	128,406,395
Operating and administrative expenses	<b>118,036,841</b>	115,533,020
Rental income, net	<b>1,746,876</b>	2,355,079
Income from operations	<b>20,891,036</b>	15,228,454
Other income, net	<b>4,183,422</b>	1,317,766
Interest expense	<b>13,712,365</b>	12,511,137
Income before income taxes	<b>11,362,093</b>	4,035,083
Income taxes:		
Current	<b>774,000</b>	4,498,000
Deferred	<b>3,343,000</b>	(2,977,000)
	<b>4,117,000</b>	1,521,000
Net income	<b>\$ 7,245,093</b>	\$ 2,514,083
Per share amounts:		
Basic earnings per common share	<b>\$ 0.31</b>	\$ 0.11
Diluted earnings per common share	<b>\$ 0.31</b>	\$ 0.11
Cash dividends per common share:		
Class A Common Stock	<b>\$ 0.165</b>	\$ 0.165
Class B Common Stock	<b>\$ 0.150</b>	\$ 0.150

See notes to unaudited interim financial statements.



**Table of Contents****INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

	<b>SIX MONTHS ENDED</b>	
	<b>March 27, 2004  (RESTATED)</b>	<b>March 29, 2003  (RESTATED)</b>
Net sales	<b>\$ 1,055,098,583</b>	\$ 984,499,148
Cost of goods sold	<b>784,581,714</b>	726,247,668
Gross profit	<b>270,516,869</b>	258,251,480
Operating and administrative expenses	<b>236,568,694</b>	231,350,848
Rental income, net	<b>3,237,591</b>	4,512,261
Income from operations	<b>37,185,766</b>	31,412,893
Other income, net	<b>5,520,866</b>	1,815,685
Interest expense	<b>27,581,958</b>	25,228,265
Income before income taxes	<b>15,124,674</b>	8,000,313
Income taxes:		
Current	<b>3,044,000</b>	6,102,000
Deferred	<b>2,432,000</b>	(3,200,000)
	<b>5,476,000</b>	2,902,000
Net income	<b>\$ 9,648,674</b>	\$ 5,098,313
Per share amounts		
Basic earnings per common share	<b>\$ 0.42</b>	\$ 0.22
Diluted earnings per common share	<b>\$ 0.42</b>	\$ 0.22
Cash dividends per common share:		
Class A Common Stock	<b>\$ 0.33</b>	\$ 0.33
Class B Common Stock	<b>\$ 0.30</b>	\$ 0.30

See notes to unaudited interim financial statements.



**Table of Contents****INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)**

SIX MONTHS ENDED MARCH 27, 2004 AND MARCH 29, 2003

	CLASS A		CLASS B		PAID-IN	RETAINED EARNINGS (RESTATED)	TOTAL (RESTATED)
	COMMON STOCK		COMMON STOCK		CAPITAL IN		
	SHARES	AMOUNT	SHARES	AMOUNT	EXCESS OF PAR VALUE		
Balance, September 28, 2002 (as previously reported)	10,189,807	\$ 509,490	12,597,932	\$ 629,897	\$ 100,148,857	\$ 137,270,604	\$ 238,558,848
Restatement adjustments						(6,992,000)	(6,992,000)
Balance, September 28, 2002 (as restated)	10,189,807	509,490	12,597,932	629,897	100,148,857	130,278,604	231,566,848
Net income						5,098,313	5,098,313
Cash dividends						(7,142,482)	(7,142,482)
Exercise of stock options	55,675	2,784			549,965		552,749
Common stock conversions	205,966	10,298	(205,966)	(10,298)			
Balance, March 29, 2003	10,451,448	\$ 522,572	12,391,966	\$ 619,599	\$ 100,698,822	\$ 128,234,435	\$ 230,075,428
Balance, September 27, 2003 (as previously reported)	10,635,419	\$ 531,770	12,391,216	\$ 619,561	\$ 102,465,443	\$ 139,946,340	\$ 243,563,114
Restatement adjustments						(6,968,000)	(6,968,000)
Balance, September 27, 2003 (as restated)	10,635,419	531,770	12,391,216	619,561	102,465,443	132,978,340	236,595,114
Net income						9,648,674	9,648,674
Cash dividends						(7,246,559)	(7,246,559)
Exercise of stock options	547,480	27,374			5,469,794		5,497,168
Common stock conversions	21,375	1,069	(21,375)	(1,069)			
<b>Balance, March 27, 2004</b>	<b>11,204,274</b>	<b>\$ 560,213</b>	<b>12,369,841</b>	<b>\$ 618,492</b>	<b>\$ 107,935,237</b>	<b>\$ 135,380,455</b>	<b>\$ 244,494,397</b>

See notes to unaudited interim financial statements.

**Table of Contents****INGLES MARKETS, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

	SIX MONTHS ENDED	
	MARCH 27,	MARCH 29,
	2004 (RESTATED)	2003 (RESTATED)
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 9,648,674	\$ 5,098,313
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	28,322,771	25,160,325
Amortization of deferred gain on sale/leasebacks	(223,135)	(423,591)
Gains on disposals of property and equipment	(5,046,329)	(1,137,596)
Receipt of advance payments from vendors	1,438,000	2,750,000
Recognition of advance payments from vendors	(3,789,852)	(1,916,669)
Increase (decrease) in deferred income taxes	2,432,000	(3,200,000)
Decrease in receivables	4,189,227	417,595
Decrease (increase) in inventory	6,577,012	(1,221,394)
Increase in other assets	(2,149,241)	(1,751,955)
Decrease in accounts payable and accrued expenses	(15,251,938)	(9,757,740)
<b>Net Cash Provided by Operating Activities</b>	<b>26,147,189</b>	<b>14,017,288</b>
<b>Cash Flows from Investing Activities:</b>		
Proceeds from sales of property and equipment	9,406,209	1,585,991
Capital expenditures	(49,456,315)	(36,977,049)
<b>Net Cash Used in Investing Activities</b>	<b>(40,050,106)</b>	<b>(35,391,058)</b>
<b>Cash Flows from Financing Activities:</b>		
Proceeds from issuance of long-term debt and advances on lines of credit		20,565,000
Debt issuance costs	(102,285)	(24,937)
Principal payments on long-term debt	(20,915,414)	(24,393,534)
Proceeds from exercise of stock options	5,497,168	552,749
Dividends paid	(7,246,559)	(7,142,482)
<b>Net Cash Used in Financing Activities</b>	<b>(22,767,090)</b>	<b>(10,443,204)</b>
<b>Net Decrease in Cash and Cash Equivalents</b>	<b>(36,670,007)</b>	<b>(31,816,974)</b>
Cash and cash equivalents at beginning of period	80,879,318	46,914,305
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 44,209,311</b>	<b>\$ 15,097,331</b>

See notes to unaudited interim financial statements.



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**INGLES MARKETS, INCORPORATED AND SUBSIDIARIES**

**NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS**

Six Months Ended March 27, 2004 and March 29, 2003

**A. BASIS OF PREPARATION**

In the opinion of management, the accompanying unaudited interim financial statements contain all adjustments necessary to present fairly the Company's financial position as of March 27, 2004, and the results of operations, changes in stockholders' equity and cash flows for the three-month and six-month periods ended March 27, 2004 and March 29, 2003. The adjustments made are of a normal recurring nature. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission for Form 10-Q. It is suggested that these unaudited interim financial statements be read in conjunction with the audited financial statements and the notes thereto included in the Annual Report on Form 10-K for the year ended September 25, 2004 filed by the Company under the Securities Exchange Act of 1934 on February 10, 2005 which includes restated audited financial statements for the year ended September 27, 2003.

The results of operations for the three-month and six-month periods ended March 27, 2004 are not necessarily indicative of the results to be expected for the full fiscal year.

Certain amounts for the three-month and six-month periods ended March 29, 2003 have been reclassified for comparative purposes.

**B. RESTATEMENT**

During preparation for its annual audit and annual report on Form 10-K for fiscal 2004 and as a result of a previously announced internal investigation initiated after an informal Securities and Exchange Commission inquiry, the Company determined that certain vendor allowances and certain other revenue and expense items were accounted for incorrectly. In addition, the Company identified accounting errors related to certain lease transactions. The accompanying condensed consolidated financial statements for the fiscal quarters and six month periods ended March 27, 2004 and March 29, 2003 are restated in order to correct these errors.

*Summary of Restatement Impact on Net Income and Retained Earnings*

The restatement resulted in an increase to income before income taxes of \$55,000 (\$34,000 net of income taxes) and \$1.1 million (\$694,000 net of income taxes) for the quarters ended March 27, 2004 and March 29, 2003, respectively.

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The restatement resulted in an increase to income before income taxes of \$1.0 million (\$640,000 net of income taxes) and \$167,000 (\$103,000 net of income taxes) for the six months ended March 27, 2004 and March 29, 2003, respectively.

The total of the cumulative adjustments to retained earnings for this restatement, before the effect of income taxes, as detailed below is approximately \$10.3 million and \$11.3 million through March 27, 2004 and September 27, 2003, respectively. The income tax benefit of these adjustments totals approximately \$4.0 million and \$4.3 million through March 27, 2004 and September 27, 2003, respectively, resulting in a net cumulative adjustment to retained earnings of approximately \$6.3 million and \$7.0 million through March 27, 2004 and September 27, 2003, respectively.

Details of the errors corrected in the restatement are as follows.

### *Vendor Allowance Errors*

Vendor allowance errors were due primarily to certain allowances related to agreements entered into prior to fiscal 2004, which were recognized in the results of operations when billed. These allowances should have been deferred and recognized over certain measurable criteria, such as purchase volumes or passage of time. Other errors included the recording of erroneous charges to vendors and the omission of the recording of receivables which were recognized in a later period than when they were earned. These errors were corrected in the period in which the error was identified, but resulted in income and expense being recorded in the incorrect periods.

The correction of these errors increased income before income taxes by approximately \$401,000 and \$693,000 for the quarters ended March 27, 2004 and March 29, 2003, respectively. For the six month period ended March 27, 2004, the correction of these errors increased income before income taxes by approximately \$1.0 million and \$325,000, respectively. The cumulative decrease to retained earnings for correction of these errors, before giving effect to income taxes, was approximately \$5.1 million and \$6.1 million at March 27, 2004 and September 27, 2003, respectively.

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*Closing Process Errors*

Closing process errors included incorrect assumptions used in calculating property tax accruals due to incorrect estimates of receivables due from tenants for the reimbursements of property taxes and incorrect or omitted accruals of certain other revenue and expense items.

The correction of these errors decreased income before income taxes by approximately \$300,000 for the quarter ended March 27, 2004, and increased income before income taxes by approximately \$484,000 for the quarter ended March 29, 2003. For the six month period ended March 27, 2004, the correction of these errors increased income before income taxes by approximately \$118,000. For the six month period ended March 29, 2003, correction of these errors decreased income before income taxes by approximately \$52,000. The cumulative decrease to retained earnings for these errors, before giving effect to income taxes, through March 27, 2004 and September 27, 2003 was approximately \$2.5 million and \$2.6 million, respectively.

*Lease Transaction Errors*

During a review of the Company's lease transactions, the Company identified errors in the accounting for certain lease transactions. These errors included the amortization of leasehold improvements over a period that exceeded the lease term and the erroneous classification of certain leasehold improvements as land, resulting in amortization expense not being recorded. In addition, the Company identified errors in accounting for certain ground leases that contained escalating rent provisions. The Company was recognizing the rent expense as it was paid instead of using the straight line method over the term of the lease.

The correction of these errors decreased income before income taxes by approximately \$46,000 and \$49,000, for the quarters ended March 27, 2004 and March 29, 2003, respectively. For the six month period ended March 27, 2004 and March 29, 2003, the correction of these errors decreased income before income taxes by approximately \$96,000 and \$102,000, respectively. The cumulative decrease to retained earnings, before giving effect to income taxes, due to errors in these lease transactions totaled approximately \$2.7 million and \$2.6 million through March 27, 2004 and September 27, 2003, respectively.

The effect of these restatements had no impact on cash flows, however the impact on the unaudited condensed consolidated balance sheets, the unaudited condensed consolidated statements of income and earnings per common share are included in the table below.

	(IN THOUSANDS, EXCEPT EARNINGS PER SHARE) AS PREVIOUSLY	
	REPORTED	AS RESTATED
<i>Condensed Consolidated Balance Sheet (unaudited)</i>		
<i>As of March 27, 2004</i>		
Cash and Cash Equivalents	\$ 44,195	\$ 44,209
Receivables	34,311	31,573
Inventories	187,718	186,826
Other Current Assets	6,953	12,709
Total Current Assets	273,177	275,317

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Property and Equipment - Net	754,706	752,717
Other Assets	14,319	14,669
Total Assets	1,042,203	1,042,704
Accounts payable, accrued expenses and current portion of other long-term liabilities	126,885	129,114
Total Current Liabilities	158,076	160,305
Deferred Income Taxes Payable	42,554	41,504
Other Long-Term Liabilities	1,892	7,543
Total Liabilities	791,380	798,209
Retained Earnings	141,708	135,380
Total Stockholders Equity	250,822	244,494
Total Liabilities and Stockholders Equity	\$ 1,042,203	\$ 1,042,704

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	(IN THOUSANDS, EXCEPT EARNINGS PER SHARE)	
	AS PREVIOUSLY	
	<u>REPORTED</u>	<u>AS RESTATED</u>
<i>Condensed Consolidated Statements of Income (unaudited)</i>		
<i>For the three months ended March 27, 2004</i>		
Net sales	\$ 521,059	\$ 520,792
Cost of goods sold	383,566	383,611
Gross profit	137,493	137,181
Operating and administrative expenses	118,427	118,037
Rental income, net	1,770	1,747
Income from operations	20,836	20,891
Income before income taxes	11,307	11,362
Income taxes	4,096	4,117
Net income	\$ 7,211	\$ 7,245
Basic earnings per common share	\$ 0.31	\$ 0.31
Diluted earnings per common share	\$ 0.31	\$ 0.31
<i>Condensed Consolidated Statements of Income (unaudited)</i>		
<i>For the six months ended March 27, 2004</i>		
Net sales	\$ 1,055,394	\$ 1,055,099
Cost of goods sold	785,991	784,582
Gross profit	269,403	270,517
Operating and administrative expenses	236,553	236,569
Rental income, net	3,284	3,238
Income from operations	36,134	37,186
Interest expense	27,570	27,582
Income before income taxes	14,085	15,125
Income taxes	5,076	5,476
Net income	\$ 9,009	\$ 9,649
Basic earnings per common share	\$ 0.39	\$ 0.42
Diluted earnings per common share	\$ 0.39	\$ 0.42
<i>Condensed Consolidated Balance Sheet (unaudited)</i>		
<i>As of September 27, 2003</i>		
Cash and Cash Equivalents	\$ 80,865	\$ 80,879
Receivables	31,014	34,221
Inventories	194,835	193,403
Other Current Assets	8,351	11,768
Total Current Assets	315,065	320,271
Property and Equipment - Net	740,834	739,023
Other Assets	15,760	16,156
Total Assets	1,071,659	1,075,450
Accounts payable, accrued expenses and current portion of other long-term liabilities	144,588	149,627
Total Current Liabilities	182,620	187,659
Deferred Income Taxes Payable	40,615	39,664
Other Long-Term Liabilities	1,930	8,600
Total Liabilities	828,096	838,855
Retained Earnings	139,946	132,978
Total Stockholders Equity	243,563	236,595
Total Liabilities and Stockholders Equity	\$ 1,071,659	\$ 1,075,450

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	(IN THOUSANDS, EXCEPT EARNINGS PER SHARE)	
	AS PREVIOUSLY	
	<u>REPORTED</u>	<u>AS RESTATED</u>
<i>Condensed Consolidated Statements of Income (unaudited)</i>		
<i>For the three months ended March 29, 2003</i>		
Cost of goods sold	\$ 361,808	\$ 360,977
Gross profit	127,575	128,406
Operating and administrative expenses	115,823	115,533
Rental income, net	2,349	2,355
Income from operations	14,101	15,228
Income before income taxes	2,908	4,035
Income taxes	1,088	1,521
Net income	\$ 1,820	\$ 2,514
Basic earnings per common share	\$ 0.08	\$ 0.11
Diluted earnings per common share	\$ 0.08	\$ 0.11
<i>Condensed Consolidated Statements of Income (unaudited)</i>		
<i>For the six months ended March 29, 2003</i>		
Cost of goods sold	\$ 726,579	\$ 726,248
Gross profit	257,920	258,251
Operating and administrative expenses	231,160	231,351
Rental income, net	4,500	4,512
Income from operations	31,261	31,412
Interest expense	25,243	25,228
Income before income taxes	7,833	8,000
Income taxes	2,838	2,902
Net income	\$ 4,995	\$ 5,098
Basic earnings per common share	\$ 0.22	\$ 0.22
Diluted earnings per common share	\$ 0.22	\$ 0.22

Certain amounts in Notes C, D, E, H and I have been restated to reflect the adjustments described above.

### C. ACCOUNTING FOR STOCK-BASED COMPENSATION

Prior to fiscal 2003, the Company accounted for its stock-based compensation plans under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ) and related interpretations. No stock-based employee compensation expense for stock options was reflected in net income for years prior to fiscal 2003, as all stock options granted under those plans had an exercise price equal to the fair market value of the underlying common stock on the date of grant. During the fourth quarter of fiscal 2003, effective as of the beginning of the 2003 fiscal year, the Company adopted the fair value recognition provisions of FASB Statement No. 123,

Accounting for Stock-Based Compensation ( FAS 123 ). Under the fair value recognition provisions of FAS 123, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Under the transition method selected by the Company as allowed by FASB Statement No. 148, Accounting for Stock-Based Compensation Transition and Disclosure ( FAS 148 ), the Company elected to apply the change in accounting principle using the prospective method. As no options were granted, modified or settled during the fiscal year ended September 27, 2003, or in the first two quarters of fiscal 2004, there was no stock-based employee compensation expense included in net income for the three-month and six-month periods ended March 27, 2004 or March 29, 2003.

Had compensation cost for the Company's plans been determined based on the fair market value at the grant date for awards granted prior to the adoption of FAS 123, the Company's earnings and earnings per share, basic and diluted, would have been reduced to the pro forma amounts

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indicated below. In accordance with FAS 123, the fair value of each option grant was determined using the Black-Scholes option-pricing model.

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	Three Months Ended		Six Months Ended	
	March 27,	March 29,	March 27,	March 29,
	2004	2003	2004	2003
<b>BASIC</b>				
Net income	\$ 7,245,093	\$ 2,514,083	\$ 9,648,674	\$ 5,098,313
Net income, pro forma	\$ 7,211,486	\$ 2,348,289	\$ 9,601,790	\$ 4,730,433
Basic earnings per common share	\$ 0.31	\$ 0.11	\$ 0.42	\$ 0.22
Basic earnings per common share, pro forma	\$ 0.31	\$ 0.10	\$ 0.41	\$ 0.21
<b>DILUTED</b>				
Diluted earnings	\$ 7,245,093	\$ 2,514,083	\$ 9,648,674	\$ 5,098,313
Diluted earnings, pro forma	\$ 7,211,486	\$ 2,348,289	\$ 9,601,790	\$ 4,730,433
Diluted earnings per common share	\$ 0.31	\$ 0.11	\$ 0.42	\$ 0.22
Diluted earnings per common share, pro forma	\$ 0.31	\$ 0.10	\$ 0.41	\$ 0.20

**D. ALLOWANCE FOR DOUBTFUL ACCOUNTS**

Receivables are presented net of an allowance for doubtful accounts of \$498,615 and \$438,509 at March 27, 2004 and September 27, 2003, respectively.

**E. ACCOUNTS PAYABLE, ACCRUED EXPENSES AND CURRENT PORTION OF OTHER LONG-TERM LIABILITIES**

Accounts payable, accrued expenses and current portion of other long-term liabilities consist of the following:

	March 27,	September 27,
	2004	2003
Accounts payable-trade	\$ 76,290,054	\$ 88,163,336
Property, payroll, and other taxes payable	9,397,554	14,750,386
Salaries, wages and bonuses payable	11,378,813	13,352,858
Self-insurance reserves	6,502,182	6,465,843
Interest	12,162,244	12,144,729
Other	13,383,135	14,750,197
	<b>\$ 129,113,982</b>	<b>\$ 149,627,349</b>

Self-insurance reserves are established for workers' compensation and employee group medical and dental benefits based on claims filed and estimates of claims incurred but not reported. The Company is insured for covered costs in excess of \$350,000 per occurrence for workers' compensation and \$200,000 per covered person for medical care benefits for a policy year. Employee insurance expense, including workers' compensation and medical care benefits, net of employee contributions, totaled \$5.4 million and \$5.0 million for the three-month periods ended March 27, 2004 and March 29, 2003, respectively. For the six-month periods ended March 27, 2004 and March 29, 2003, employee insurance

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expense, net of employee contributions, totaled \$9.3 million and \$9.7 million, respectively.

### F. LONG-TERM DEBT

On May 29, 2003, the Company closed an offering of an additional \$100.0 million of the existing 8 <sup>7</sup>/<sub>8</sub>% Senior Subordinated Notes (the Notes ) due December 11, 2011, at a premium to yield 8.67%. A portion of the proceeds was used to repay \$30.5 million of outstanding debt. The additional Notes bear the same terms and maturity date as the original issuance.

At March 27, 2004, the Company had lines of credit with five banks totaling \$135.0 million, all of which were unused. Of the \$135.0 million of committed lines of credit, \$120.0 million of the commitment expires in October 2006, and \$15.0 million of the commitment expires in October and November 2004. The lines provide the Company with various interest rate options generally at rates less than prime. The Company is not required to maintain compensating balances in connection with these lines of credit. The Company was in compliance with all financial covenants related to these lines of credit at March 27, 2004.

### G. DIVIDENDS

The Company paid cash dividends of \$0.165 for each share of Class A Common Stock and \$0.15 for each share of Class B Common Stock on January 14, 2004 and October 8, 2003 to stockholders of record on January 5, 2004 and September 30, 2003, respectively.

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## H. EARNINGS PER COMMON SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended		Six Months Ended	
	March 27, 2004	March 29, 2003	March 27, 2004	March 29, 2003
<b>BASIC:</b>				
Net income	\$ 7,245,093	\$ 2,514,083	\$ 9,648,674	\$ 5,098,313
Weighted average number of common shares outstanding	23,343,818	22,827,745	23,188,358	22,835,580
Basic earnings per common share	\$ 0.31	\$ 0.11	\$ 0.42	\$ 0.22
<b>DILUTED:</b>				
Net income	\$ 7,245,093	\$ 2,514,083	\$ 9,648,674	\$ 5,098,313
Weighted average number of common shares and common stock equivalent shares outstanding	23,430,088	23,034,349	23,244,866	23,095,578
Diluted earnings per common share item	\$ 0.31	\$ 0.11	\$ 0.42	\$ 0.22

## I. LINES OF BUSINESS

The Company operates three lines of business: retail grocery sales, shopping center rentals, and a fluid dairy processing plant. All of the Company's operations are domestic. Information about the Company's operations by lines of business (in thousands) is as follows:

	Three Months Ended		Six Months Ended	
	March 27, 2004	March 29, 2003	March 27, 2004	March 29, 2003
<b>Revenues from unaffiliated customers:</b>				
Grocery sales	\$ 495,874	\$ 466,057	\$ 1,005,185	\$ 938,627
Shopping center rentals	3,526	4,082	6,878	7,921
Fluid dairy	24,918	23,326	49,914	45,872
<b>Total revenues from unaffiliated customers</b>	<b>\$ 524,318</b>	<b>\$ 493,465</b>	<b>\$ 1,061,977</b>	<b>\$ 992,420</b>

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<b>Income from operations:</b>				
Grocery sales	\$ 16,664	\$ 10,148	\$ 29,469	\$ 21,386
Shopping center rentals	1,747	2,355	3,238	4,512
Fluid dairy	2,480	2,725	4,479	5,515
<b>Total income from operations</b>	<b>\$ 20,891</b>	<b>\$ 15,228</b>	<b>\$ 37,186</b>	<b>\$ 31,413</b>

	March 27, 2004	September 27, 2003		
<b>Assets:</b>				
Grocery sales	\$ 897,449	\$ 932,860		
Shopping center rentals	114,923	112,264		
Fluid dairy	30,332	30,326		
<b>Total assets</b>	<b>\$ 1,042,704</b>	<b>\$ 1,075,450</b>		

Revenue from shopping center rentals is reported on the rental income, net line of the income statements. The other revenues comprise the net sales reported.

For the three months ended March 27, 2004 and March 29, 2003, respectively, the fluid dairy segment had \$11.5 and \$11.3 million in sales to the grocery sales segment. The fluid dairy segment had \$23.5 and \$22.7 million in sales to the grocery sales segment in the six-month periods ended March 27, 2004 and March 29, 2003, respectively. These sales have been eliminated in consolidation and are excluded from the amounts in the table above.

#### J. NEW ACCOUNTING PRONOUNCEMENTS

EITF (Emerging Issues Task Force) Issue No. 02-16, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor, became effective for the Company on December 29, 2002. This issue addresses the appropriate accounting for consideration received from a vendor. Due to system constraints and the nature of certain allowances, it is sometimes not practicable to apply allowances to the item cost of inventory. As a result of this new guidance and these constraints, the Company adopted a new policy for recognizing vendor allowances, including slotting fees. The Company now recognizes these allowances as a reduction to inventory and ultimately to cost of goods sold when the related products are sold, for agreements entered into or modified subsequent to December 29, 2002. Under the Company's previous accounting policy for vendor allowances, including slotting fees, these credits were recognized as a reduction to cost of goods sold as soon as the amount was contractually established and collection was deemed probable.

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In January 2003, the FASB released Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46). FIN 46 requires that all primary beneficiaries of Variable Interest Entities (VIE) consolidate that entity. FIN 46 is effective immediately for VIEs created or acquired after January 31, 2003. It applies in the first fiscal year or interim period ending after March 15, 2004, to VIEs in which an enterprise holds an interest it acquired before February 1, 2003. The Company has determined that it does not have any relationships or contracts that constitute VIEs.

## **Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### ***Restatement***

During preparation for its annual audit and annual report on Form 10-K for fiscal 2004 and as a result of a previously announced internal investigation initiated after an informal Securities and Exchange Commission inquiry, the Company determined that certain vendor allowances and certain other revenue and expense items had been accounted for incorrectly. In addition, the Company identified accounting errors related to certain lease transactions. Ingles is filing this Form 10-Q/A for purposes of restating its consolidated financial statements for the periods ended March 27, 2004 and March 29, 2003 in order to correct the errors identified above. The adjustments made to Ingles' financial statements are further described in Note B to the consolidated financial statements. All discussion in this Management's Discussion and Analysis of Financial Condition and Results of Operations gives effect to the restatement.

### ***Overview***

Ingles, a leading supermarket chain in the Southeast, operates 197 supermarkets in Georgia (80), North Carolina (60), South Carolina (33), Tennessee (21), Virginia (2) and Alabama (1). The Company locates its supermarkets primarily in suburban areas, small towns and rural communities. Ingles supermarkets offer customers a wide variety of nationally advertised food products, including grocery, meat and dairy products, produce, frozen foods and other perishables and non-food products, including health and beauty care products and general merchandise, as well as quality private label items. In addition, the Company focuses on selling high-growth, high-margin products to its customers through the development of book sections, media centers, floral departments, bakery departments and prepared foods including delicatessen sections. During fiscal 2000, the Company began adding fuel centers and pharmacies at select store locations. As of March 27, 2004, the Company operated 29 in-store pharmacies and 18 fuel centers.

Ingles also operates two other lines of business, fluid dairy processing and shopping center rentals. The fluid dairy processing segment sells approximately 32% of its products to the retail grocery segment and approximately 68% of its products to third parties. Real estate ownership (including the shopping center rental segment) is an important component of the Company's operations, providing both operational and economic benefit.

### ***Critical Accounting Policies***

Critical accounting policies are those accounting policies that management believes are important to the portrayal of Ingles' financial condition and results of operations, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

*Self-Insurance*

The Company is self-insured for workers' compensation and group medical and dental benefits. Risks and uncertainties are associated with self-insurance; however, the Company has limited its exposure by maintaining excess liability coverage. Self-insurance reserves are established based on claims filed and estimates of claims incurred but not reported. The estimates are based on data provided by the respective claims administrators. The majority of the Company's properties are self-insured for casualty losses and business interruption; however, liability coverage is maintained.

*Asset Impairments*

The Company accounts for the impairment of long-lived assets in accordance with Statement of Financial Accounting Standards No. 144. For assets to be held and used, the Company tests for impairment using undiscounted cash flows and calculates the amount of impairment using discounted cash flows. For assets held for sale, impairment is recognized based on the excess of remaining book value over expected recovery value. The recovery value is the fair value as determined by independent quotes or expected sales prices developed by internal specialists. Estimates of future cash flows and expected sales prices are judgments based upon the Company's experience and knowledge of local operations and cash flows that are projected for several years into the future. These estimates can fluctuate significantly due to changes in real estate market conditions, the economic environment, capital spending decisions and inflation.

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*Closed Store Accrual*

For properties closed prior to December 31, 2002 that were under long-term lease agreements, the present value of any remaining liability under the lease, discounted using risk-free rates and net of expected sublease recovery, is recognized as a liability and expensed. For all store closures subsequent to the adoption of Statement of Financial Accounting Standards No. 146, effective December 31, 2002, the liability is recognized and expensed based on the difference between the present value of any remaining liability under the lease and the present value of the estimated market rate at which the Company expects to be able to sublease the properties. The Company's estimates of market rates are based on its experience, knowledge and third-party advice or market data. If the real estate and leasing markets change, sublease recovery could vary significantly from the recoveries originally assumed, resulting in a material change in the Company's recorded liability.

*Vendor Allowances*

The Company receives funds for a variety of merchandising activities from the many vendors whose products the Company buys for resale in its stores. These incentives and allowances include volume or purchase based incentives, advertising allowances, slotting fees, and promotional discounts. The purpose of these incentives and allowances is generally to help defray the costs incurred by the Company for stocking, advertising, promoting and selling the vendor's products. Whenever possible, vendor discounts and allowances that relate to buying and merchandising activities are recorded as a component of item cost in inventory and recognized in merchandise costs when the item is sold. Due to system constraints and the nature of certain allowances, it is sometimes not practicable to apply allowances to the item cost of inventory. In those instances, the allowances are applied as a reduction of merchandise costs using a rational and systematic methodology, which results in the recognition of these incentives when the inventory related to the initial purchase is sold. Amounts that represent a reimbursement of specific identifiable incremental costs, such as advertising, are recorded as a reduction to the related expense in the period that the related expense is incurred.

***Results of Operations***

Ingles operates on a 52 or 53-week fiscal year ending on the last Saturday in September. There are 13 and 26 weeks of operations included in the unaudited condensed consolidated statements of income for the three and six-month periods ended March 27, 2004 and March 29, 2003. Comparable store sales are defined as sales by grocery stores in operation for the entire duration of the previous and current fiscal years. Replacement stores and major and minor remodels are included in the comparable store sales calculation. A replacement store is a new store that is opened to replace an existing nearby store that is closed. A major remodel entails substantial remodeling of an existing store and may include additional retail square footage. A minor remodel includes repainting, remodeling and updating the lighting and equipment throughout an existing store. For the three and six-month periods ended March 27, 2004 and March 29, 2003, comparable store sales include 193 stores.

The following table sets forth, for the periods indicated, selected financial information as a percentage of net sales. For information regarding the various segments of the business, see Note I "Lines of Business" to the Unaudited Consolidated Financial Statements.

<b>Three Months Ended</b>		<b>Six Months Ended</b>	
<b>March 27,</b>	<b>March 29,</b>	<b>March 27,</b>	<b>March 29,</b>
<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
<b>(RESTATED)</b>	<b>(RESTATED)</b>	<b>(RESTATED)</b>	<b>(RESTATED)</b>

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Net sales	<b>100.0%</b>	100.0%	<b>100.0%</b>	100.0%
Gross profit	<b>26.3%</b>	26.2%	<b>25.6%</b>	26.2%
Operating and administrative expenses	<b>22.6%</b>	23.6%	<b>22.4%</b>	23.5%
Rental income, net	<b>0.3%</b>	0.5%	<b>0.3%</b>	0.5%
Income from operations	<b>4.0%</b>	3.1%	<b>3.5%</b>	3.2%
Other income, net	<b>0.8%</b>	0.3%	<b>0.5%</b>	0.2%
Interest expense	<b>2.6%</b>	2.6%	<b>2.6%</b>	2.6%
Income before income taxes	<b>2.2%</b>	0.8%	<b>1.4%</b>	0.8%
Income taxes	<b>0.8%</b>	0.3%	<b>0.5%</b>	0.3%
Net income	<b>1.4%</b>	0.5%	<b>0.9%</b>	0.5%

**Three Months Ended March 27, 2004 Compared to the Three Months Ended March 29, 2003**

*Net Sales.* Net sales increased 6.4% to \$520.8 million for the three months ended March 27, 2004 from \$489.4 million for the three months ended March 29, 2003. Ingles operated 197 stores at March 27, 2004, compared to 200 stores at March 29, 2003. Retail square footage increased 0.1 million square feet or 0.9% from March 2003 to March 2004. Comparable store sales for the same period grew \$25.7 million or 5.6%. Ingles introduced its Ingles Advantage Savings and Rewards Card ( the Card ) the first day of the 2004 fiscal year. The increase in net sales and comparable store sales is partially attributable to the success of the Card program. Sales improved in each department; however the largest percentage increase in sales was in the meat department, which was partially attributable to inflation in beef prices during the quarter and the trend toward low carbohydrate diets.

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Net sales to outside parties for the Company's milk processing subsidiary increased \$1.6 million or 6.8% in the March 2004 quarter compared to the March 2003 quarter. The sales increase is primarily attributable to an increase in raw milk costs in the March 2004 quarter compared to the March 2003 quarter, which is passed on to the subsidiary's customers in the pricing of milk products.

The Company expects moderate sales growth in the remainder of fiscal year 2004 as it experiences results from marketing programs with the Card and new and expanded stores mature.

*Gross Profit.* Gross profit for the three-month period ended March 27, 2004, increased \$8.8 million or 6.8% to \$137.2 million, or 26.3% of sales, compared to \$128.4 million, or 26.2% of sales, for the three-month period ended March 29, 2003. Until January 1, 2003, the Company recognized certain vendor allowances, principally slotting fees, as a reduction to cost of goods sold as soon as the amount was contractually established and collection was probable. Under EITF 02-16, the Company changed its policy to include these allowances as a reduction in inventory value. Adoption of this policy in the March 2003 quarter resulted in a one time non-cash charge to cost of goods sold of \$2.6 million, or 2.1% of the 6.8% increase in gross profit. The remaining 4.7% increase was due primarily to the higher sales volume.

Gross profit for the Company's milk processing subsidiary remained virtually unchanged for the March 2004 quarter compared to the March 2003 quarter. Although sales increased, gross profit as a percentage of sales declined as the raw milk cost was passed on to customers on a dollar basis.

In addition to the direct product cost, the cost of goods sold line item for the grocery segment includes inbound freight charges. Purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs, and other costs of the Company's distribution network are included in operating and administrative expenses. The milk processing segment is a manufacturing process. Therefore, all of the costs mentioned above incurred by the milk processing segment are included in the cost of sales line item.

The Company's gross margins may not be comparable to those of other retailers, since some retailers include all of the costs related to their distribution network in cost of goods sold and others, like the Company, exclude a portion of the costs from gross profit, including the costs instead in a line item such as operating and administrative expenses.

*Operating and Administrative Expenses.* Operating and administrative expenses increased \$2.5 million or 2.2% to \$118.0 million for the three months ended March 27, 2004, from \$115.5 million for the three months ended March 29, 2003. As a percentage of sales, operating and administrative expenses decreased to 22.6% for the three months ended March 27, 2004 compared to 23.6% for the three months ended March 29, 2003, respectively. A variety of factors contributed to the dollar increase.

A breakdown of the major increases (decreases) in operating and administrative expenses is as follows:

(RESTATED)	Increase (decrease) as a %
<u>In millions</u>	<u>of sales</u>

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Salaries and wages	\$	2.9	
Equipment rent	\$	(3.2)	(0.7)%
Depreciation and amortization	\$	1.4	0.1%
Advertising and promotion	\$	(1.4)	(0.3)%
Taxes and licenses	\$	0.7	0.1%
Insurance	\$	0.7	0.1%
Store supplies	\$	0.6	0.1%

Salaries and wages increased in dollars due to additional labor hours required for the increased sales volume but remained constant at 9.3% of sales for both the March 2004 and 2003 quarters.

Equipment rent declined due to the purchase at the beginning of fiscal 2004 of \$7.6 million in existing store equipment that was previously under an operating lease.

Depreciation and amortization expense increased due both to new stores and stores remodeled and expanded in fiscal 2003 and the first half of fiscal 2004, as well as to the purchase of the store equipment previously under an operating lease mentioned above. The increase in depreciation expense for the repurchase of the store equipment was approximately \$0.4 million for the March 2004 quarter.

Advertising and promotion expense decreased due to the revamping of the Company's advertising program including the elimination of less effective promotions and the renegotiation of agreements with major advertising vendors resulting in the reduction of ongoing charges.

Taxes and licenses increased primarily due to increased property tax expense and higher payroll taxes as a result of increased salaries and wages.

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Insurance expense increased primarily due to higher premiums for liability coverages.

The increase in store supplies expense is primarily attributable to the use of supplies to support the higher sales volume. In addition there were increased supply expenses for the Card program including the cost of cards, applications, signage and tags.

*Rental Income, Net.* Rental income, net decreased \$0.6 million to \$1.8 million for the March 2004 quarter from \$2.4 million for the March 2003 quarter. The decrease consists of gross rental income decreases of \$0.5 million and operating cost increases of \$0.1 million. The sale of shopping centers in September 2003 and January 2004 in which Ingles was not a tenant, the rejection of certain leases in bankruptcy proceedings of K-Mart and Price Cutters and the relocation of several drug stores from shopping centers to stand alone sites all decreased gross rental income. Partially offsetting these decreases was rent from a tenant in a stand alone retail store purchased by the Company at the beginning of fiscal 2004.

*Other Income, Net.* Other income, net increased \$2.9 million to \$4.2 million for the three-month period ended March 27, 2004 from \$1.3 million for the three-month period ended March 29, 2003. During the March 2004 quarter, the Company sold a shopping center in which it no longer operated a store for a gain of \$3.9 million. In the March 2003 quarter, the Company also sold a shopping center in which it no longer operated a store for a gain of \$1.1 million.

*Interest Expense.* Interest expense increased \$1.2 million for the three-month period ended March 27, 2004 to \$13.7 million from \$12.5 million for the three-month period ended March 29, 2003. In May 2003, the Company issued an additional \$100.0 million of its existing 8<sup>7/8</sup>% Senior Subordinated Notes, due December 2011 (the Notes ) for a total of \$349.8 million. A portion of the proceeds of the Notes was used to repay \$30.5 million of existing debt. Debt retired with the proceeds from the Notes generally had lower interest rates and shorter maturity than the Notes. Although total debt at March 2004 was \$620.0 million compared to \$592.8 million at March 2003, net debt (total debt less total cash) decreased \$1.9 million due to the higher cash balance at March 2004 from invested proceeds from the Notes.

*Income Taxes.* Income tax expense as a percentage of pre-tax income decreased to 36.2% in the March 2004 quarter compared to 37.7% in the March 2003 quarter.

*Net Income.* Net income increased \$4.7 million or 188.0% for the three-month period ended March 27, 2004 to \$7.2 million compared to \$2.5 million for the three-month period ended March 29, 2003. Net income, as a percentage of sales, was 1.4% for the March 2004 quarter and 0.5% for the March 2003 quarter. Basic and diluted earnings per share were \$0.31 and \$0.11 for the March 2004 and March 2003 quarters, respectively. The one time charge from adoption of EITF 02-16 reduced net income \$1.6 million, or \$0.07 per diluted share, in the March 2003 quarter.

## **Six Months Ended March 27, 2004 Compared to the Six Months Ended March 29, 2003**

*Net Sales.* Net sales for the six months ended March 27, 2004 increased 7.2% to \$1.06 billion, compared to \$984.5 million for the six months ended March 29, 2003. Comparable store sales increased \$55.2 million or 6.0% for the same period. As mentioned in the three-month discussion, the increase in net sales and comparable store sales is partially attributable to the success of the Card program. Sales improved in each department; however the largest percentage increase in sales was in the meat department, which was partially attributable to inflation in beef prices during the six-month period and the trend towards lower carbohydrate diets.

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Net sales to outside parties for the Company's milk processing subsidiary increased \$4.0 million or 8.8% in the March 2004 six-month period compared to the March 2003 six-month period due to the increased raw milk costs mentioned above in the three-month discussion, partially offset by the loss of two high margin food service cream accounts.

The Company expects moderate sales growth in the remainder of fiscal year 2004 as it experiences results from marketing programs with the Card and new and expanded stores mature.

*Gross Profit.* Gross profit for the six months ended March 27, 2004 increased 4.8% to \$270.5 million compared to \$258.3 million, for the six months ended March 29, 2003. As a percent of sales, gross profit decreased to 25.6% for the six months ended March 27, 2004 from 26.2% for the six months ended March 29, 2003.

The one time charge from adoption of EITF 02-16 resulted in a non-cash charge to cost of goods sold of \$2.6 million, or 1.0% of the 4.8% increase in gross profit, during the six-month period ended March 29, 2003. The remaining 3.8% increase was due to the higher sales volume, partially offset by a 43 basis point decline in gross profit as a percentage of sales due to increased promotional activity.

Gross profit for the Company's milk processing subsidiary decreased \$1.0 million or 9.8% for the March 2004 six-month period compared to the March 2003 six-month period due primarily to the loss of two high margin food service cream accounts.

*Operating and Administrative Expenses.* Operating and administrative expenses increased \$5.2 million or 2.3% to \$236.5 million for the six months ended March 27, 2004, from \$231.3 million for the six months ended March 29, 2003. As a percentage of sales, operating and administrative expenses decreased to 22.4% for the March 2004 six-month period from 23.5% for the same period last year. A variety of factors contributed to the dollar increase.

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A breakdown of the major increases (decreases) in operating and administrative expenses is as follows:

	(RESTATED) In millions	Increase (decrease) as a % of sales
Salaries and wages	\$ 6.6	
Equipment rent	\$ (6.3)	(0.7)%
Depreciation and amortization	\$ 2.9	0.1%
Advertising and promotion	\$ (2.9)	(0.4)%
Taxes and licenses	\$ 1.0	
Warehousing and transportation	\$ 0.9	
Store supplies	\$ 1.3	0.1%
Utilities	\$ 0.6	0.1%

Salaries and wages increased in dollars due to additional labor hours required for the increased sales volume but remained constant at 9.2% of sales for both the March 2004 and 2003 six-month periods.

Equipment rent declined due to the purchase at the beginning of fiscal 2004 of \$7.6 million in existing store equipment that was previously under an operating lease.

Depreciation and amortization expense increased due both to new stores and stores remodeled and expanded in fiscal 2003 and the first half of fiscal 2004, as well as to the purchase of the store equipment previously under an operating lease mentioned above. The increase in depreciation expense for the repurchase of the store equipment was approximately \$0.8 million for the March 2004 six-month period.

Advertising and promotion expense decreased due to the revamping of the Company's advertising program including the elimination of less effective promotions and the renegotiation of agreements with major advertising vendors resulting in the reduction of ongoing charges.

Taxes and licenses increased primarily due to increased property tax expense and higher payroll taxes as a result of increased salaries and wages.

Warehousing and transportation increased due to both higher labor costs, particularly in the first quarter of fiscal 2004 and increased fuel costs.

The increase in store supplies expense is primarily attributable to the use of supplies to support the higher sales volume. In addition there were increased supply costs for the Card program including the cost of cards, applications, signage and tags. The Company estimates that \$0.4 million of the supply costs were incurred with the introduction of the Card.

Utility expense increased 3.6% due primarily to higher utility rates.

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*Rental Income, Net.* Rental income, net decreased \$1.3 million to \$3.2 million in the March 2004 six-month period from \$4.5 million in the March 2003 comparable period. Gross rental income decreased \$1.1 million, while shopping center expenses (primarily depreciation) increased \$0.2 million. The sale of shopping centers in September 2003 and January 2004 in which Ingles was not a tenant, the rejection of certain leases in bankruptcy proceedings of K-Mart and Price Cutters and the relocation of several drug stores from shopping centers to stand alone sites all decreased gross rental income. Partially offsetting these decreases was rent from a tenant in a stand alone retail store purchased by the Company during the beginning of fiscal 2004.

*Other Income, Net.* Other income, net increased \$3.7 million for the March 2004 six-month period over the comparable period in fiscal 2003. During the March 2004 six-month period, the Company sold a shopping center in which it no longer operated a store for a gain of \$3.9 million and an out-parcel adjacent to an existing shopping center for a gain of \$1.0 million. In the March 2003 six-month period, the Company also sold a shopping center in which it no longer operated a store for a gain of \$1.1 million.

*Interest Expense.* Interest expense increased \$2.4 million to \$27.6 million for the six months ended March 27, 2004 from \$25.2 million for the six months ended March 29, 2003, due primarily to the issuance of the Notes in May 2003 mentioned in the three-month discussion.

*Income Taxes.* Income tax expense as a percentage of pre-tax income decreased slightly to 36.2% in the March 2004 six-month period from 36.3% in the March 2003 six-month period.

*Net Income.* Net income increased \$4.5 million or 89.2% for the March 2004 six-month period to \$9.6 million, or 0.9% of sales, compared to \$5.1 million, or 0.5% of sales, for the March 2003 six-month period. Basic and diluted earnings per common share were \$0.42 and \$0.22 for the March 2004 and March 2003 six-month period, respectively. The one time charge from adoption of EITF 02-16 reduced net income \$1.6 million, or \$0.07 per diluted share, in the March 2003 six-month period.

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### ***Liquidity and Capital Resources***

#### ***Capital Expenditures***

The Company believes that a key to its ability to continue to develop a loyal customer base is providing conveniently located, clean and modern stores which provide customers with good service and a broad selection of competitively priced products. As such, the Company has invested and will continue to invest significant amounts of capital toward the modernization of its store base. The Company's modernization program includes the opening of new stores, the completion of major remodels and expansion of selected existing stores, the relocation of selected existing stores to larger, more convenient locations and the completion of minor remodeling of its remaining existing stores.

Capital expenditures totaled \$49.4 million for the six-month period ended March 27, 2004 including the completion of major remodel/expansions at two stores, minor remodels at two stores and the opening of one fuel station. Capital expenditures also included the purchase of four store sites, two shopping centers in which Ingles is a tenant and one free standing retail store leased to another retailer. Also included in the six-month capital expenditure amount is the purchase of \$7.6 million of existing store equipment previously under an operating lease. Capital expenditures included the costs of upgrading and replacing store equipment, technology investments, capital expenditures related to the Company's distribution operation and its milk processing plant, and expenditures for stores to open later in fiscal 2004 and in fiscal 2005. Capital expenditures were more heavily weighted in the first six months of the year as the Company had 180 days from the sale of the shopping center in September 2003 to reinvest the proceeds in a like kind exchange in order to defer the tax impact of the sale.

Ingles' capital expenditure plans for all of fiscal 2004 include investments of approximately \$70 million. For the balance of fiscal 2004, the Company plans to open one new store and one replacement store, complete one major remodel/expansion, add approximately six new fuel stations on existing store sites and purchase two store sites for future expansion. Expenditure plans will also include investments in stores expected to open in fiscal 2005 as well as technology improvements, upgrading and replacing existing store equipment, warehouse and transportation equipment, and improvements to the Company's milk processing plant.

The Company expects that its net annual capital expenditures will remain in the range of approximately \$60.0 to \$70.0 million going forward in order to maintain a modern store base. The number of projects pursued during each fiscal year could decline to some degree as the Company increases the average size of stores built. The number of projects may also fluctuate due to the varying costs of the types of projects pursued including new stores, major remodel/expansions or minor remodels. The Company makes decisions on the allocation of capital expenditure dollars based on many factors including the competitive environment, other Company capital initiatives and its financial condition.

The Company does not generally enter into commitments for capital expenditures other than on a store-by-store basis at the time it begins construction on a new store or begins a major or minor remodeling project. The Company generally engages in major remodeling and new store development on not more than three or four locations at a time. Construction commitments at March 27, 2004 totaled \$8.0 million.

#### ***Liquidity***

The Company generated net cash from operations of \$26.1 million in the March 2004 six-month period.

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Cash used by investing activities for the March 2004 six-month period totaled \$40.0 million comprised primarily of \$49.4 million of capital expenditures during the period, partially offset by \$9.4 million of proceeds from the sale of assets.

Cash used by financing activities during the March 2004 six-month period totaled \$22.8 million including principal payments on long-term debt of \$20.9 million and dividend payments of \$7.2 million offset in part by cash received from the exercise of stock options of \$5.5 million.

At March 27, 2004, the Company had lines of credit with five banks totaling \$135.0 million, all of which were unused. Of the \$135.0 million of committed lines of credit, \$120.0 million of the commitment expires in October 2006 and \$15.0 million of the commitment expires in October and November 2004. The lines provide the Company with various interest rate options generally at rates less than prime. The Company is not required to maintain compensating balances in connection with these lines of credit. The Company was in compliance with all financial covenants related to these lines of credit at March 27, 2004.

The Company's principal sources of liquidity are expected to be cash flow from operations, borrowings under its lines of credit and long-term financing. As of March 27, 2004, the Company had unencumbered real property and equipment with a net book value of approximately \$335.5 million. The Company believes, based on its current results of operations and financial condition, that its financial resources, including existing bank lines of credit, short- and long-term financing expected to be available to it and internally generated funds, will be sufficient to meet planned capital expenditures and working capital requirements for the foreseeable future, including any debt service requirements of additional borrowings. However, there can be no assurance that any such sources of financing will be available to the Company on acceptable terms, or at all.

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It is possible that, in the future, the Company's results of operations and financial condition will be different from that described in this report based on a number of intangible factors. These factors may include, among others, increased competition, changing regional and national economic conditions, adverse climatic conditions affecting food production and delivery and changing demographics as well as the additional factors discussed below under "Forward Looking Statements". It is also possible, for such reasons, that the results of operations from the new, expanded, remodeled and/or replacement stores will not meet or exceed the results of operations from existing stores that are described in this report.

### *Contractual Obligations and Commercial Commitments*

There have been no material changes in contractual obligations and commercial commitments subsequent to September 27, 2003.

### *Off Balance Sheet Arrangements*

The Company is not a party to any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on the Company's financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

### *Quarterly Cash Dividends*

Since December 27, 1993, the Company has paid regular quarterly cash dividends of \$0.165 (sixteen and one-half cents) per share on its Class A Common Stock and \$0.15 (fifteen cents) per share on its Class B Common Stock for an annual rate of \$0.66 and \$0.60 per share, respectively.

The Company expects to continue paying regular cash dividends on a quarterly basis. However, the Board of Directors periodically reconsiders the declaration of dividends. The Company pays these dividends at the discretion of the Board of Directors and the continuation of these payments, the amount of such dividends, and the form in which the dividends are paid (cash or stock) depends upon the results of operations, the financial condition of the Company and other factors which the Board of Directors deems relevant. In addition, certain loan agreements containing provisions outlining minimum tangible net worth requirements restrict the ability of the Company to pay additional dividends to approximately \$35.2 million based on tangible net worth at March 27, 2004. Further, the Company is prevented from declaring dividends at any time that it is in default under the indenture governing the Notes. In addition, the terms of the indenture may restrict the ability of the Company to pay additional dividends based on certain financial parameters.

### *Seasonality*

Sales in the grocery segment of the Company's business are subject to a slight seasonal variance due to holiday related sales. Sales are traditionally higher in the Company's first fiscal quarter due to the inclusion of sales related to Thanksgiving and Christmas. The Company's second fiscal quarter traditionally has the lowest sales of the year, unless Easter falls in that quarter. The fluid dairy segment of the Company's business has slight seasonal variation to the extent of its sales into the grocery industry. The Company's real estate segment is not subject to seasonal variations.

*Impact of Inflation*

Inflation in food prices during the March 2004 quarter and six-month period was slightly higher than the overall increase in the Consumer Price Index. One of the Company's significant costs is labor, which increases with inflation.

*New Accounting Pronouncements*

For new accounting pronouncements, see Note J to the Unaudited Financial Statements.

*Forward Looking Statements*

This Annual Report contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. The words "expect", "anticipate", "intend", "plan", "believe", "seek" and similar expressions are intended to identify forward-looking statements. While the forward-looking statements and the related assumptions are made in good faith and reflect the Company's current judgment regarding the direction of its business, actual results will almost always vary, sometimes materially, from any estimates, predictions, projections, assumptions or other future performance suggested herein. Such statements are based upon a number of assumptions and estimates which are inherently subject to significant risks and uncertainties many of which are beyond the Company's control. Some of these assumptions inevitably will not materialize, and unanticipated events will occur which will affect the Company's results. Some important factors (but not necessarily all factors) that affect the Company's revenues, growth strategies, future profitability and operating results, or that otherwise could cause actual results to differ materially from those expressed in or implied by any forward-looking statement, include business and economic conditions generally in the Company's operating area; the Company's ability to successfully implement its expansion and operating strategies and to manage rapid

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expansion; pricing pressures and other competitive factors; the Company's ability to reduce costs and achieve improvements in operating results; the availability and terms of financing; increases in labor and utility costs; success or failure in the ownership and development of real estate; changes in the laws and government regulations applicable to the Company; and changes in accounting policies, standards, guidelines or principles as may be adopted by regulatory agencies as well as the Financial Accounting Standards Board.

Consequently, actual events affecting the Company and the impact of such events on the Company's operations may vary significantly from those described in this report or contemplated or implied by statements in this report.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in market interest rates subsequent to September 27, 2003.

**Item 4. CONTROLS AND PROCEDURES**

The Company maintains disclosure controls and procedures designed to provide reasonable assurance of achieving the objective that information in its Exchange Act reports is recorded, processed, summarized and reported within the time periods specified and pursuant to the regulations of the Securities and Exchange Commission. Disclosure controls and procedures, as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act, include controls and procedures designed to ensure the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. It should be noted that the Company's system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met.

On December 6, 2004, the Company announced that it was delaying the filing of its Form 10-K for the fiscal year ended September 25, 2004 due to its internal investigation of certain vendor allowances and related accounting in prior periods. The Company filed a Form 12b-25 with respect to that delayed filing on December 9, 2004. The Company is filing this Form 10-Q/A for the fiscal quarter ended March 27, 2004 to reflect the restatement of its unaudited consolidated financial statements, the notes thereto, and the related disclosures to reflect the proper recognition of vendor allowances and certain revenue and expense items in the appropriate accounting period. In addition, the Company identified accounting errors related to certain lease transactions which have been corrected as a part of this restatement. The Company has also filed Forms 10-Q/A for the fiscal quarters ended December 27, 2003, and June 26, 2004 to reflect the restatement of its consolidated financial statements included therein, the notes thereto, and related disclosures for such fiscal periods. The Company is also filing its Form 10-K for its fiscal year ended September 25, 2004 reflecting restatements of its financial statements for the fiscal years 2002 and 2003 for the same reasons mentioned above.

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with participation of its management including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures as of March 27, 2004, the end of the period covered by this report. In making this evaluation, it considered matters relating to the restatement of its consolidated financial statements, including the related weaknesses in its internal control over financial reporting identified during the internal investigation. After consideration of the matters discussed above, the Company has concluded that its controls and procedures were not effective in all respects as of the end of the period covered by this report.

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The errors giving rise to the restatement relate to the recognition of certain vendor allowances in the Company's financial statements, the recording of certain other revenue and expense items in the proper accounting period principally due to errors in the financial statement closing process and errors in the accounting for certain lease transactions.

The errors related to the recognition of vendor allowances occurred because of a variety of factors including incomplete or inaccurate information concerning vendor allowances provided internally by certain company associates dealing with vendors, due in certain circumstances to inappropriate actions of certain former officers of the Company, and the complexity of guidance relating to the accounting for vendor allowances. Prior to the quarter covered by this report, the Company had implemented additional controls and procedures designed to ensure that information regarding vendor allowances provided internally was complete and accurate, including new requirements regarding the signing of vendor invoices and new approvals for vendor invoices and contracts with vendors, however such controls did not address the reporting or disclosure of previously recorded transactions. The Company believes that these additional controls and procedures substantially corrected any material weakness in existence prior to the March 2004 quarter relating to the recognition of vendor allowances.

In reviewing its controls following the internal investigation, the Company has determined that additional training regarding controls over the accounting for vendor allowances is necessary for its accounting and other staff dealing with vendor allowances. Further, the Company has concluded that there were material weaknesses in its internal controls for financial reporting relating to its period closing process and particularly related to its systems and process between the Company's accounting department and its real estate department regarding the recognition of tenant reimbursements of expenses paid by the Company. In addition, in a review of its lease transactions, the Company identified accounting errors related to certain lease transactions. These errors resulted from a lack of understanding and communication of the Company's accounting policies related to leasehold improvements, incomplete reviews of such transactions and the complexity of guidance for lease accounting.

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In order to remediate the remaining weaknesses in internal controls, the Company has reviewed the staffing functions in its accounting and real estate departments, including monitoring of compliance with accounting policies and procedures. The Company is considering the hiring of additional staff to supplement existing resources. Further, it intends to provide additional training to associates of the Company. These changes, among others, will allow the accounting department to more closely monitor the vendor allowance transactions, its real estate billing processes and lease transactions, and to achieve a more accurate financial statement close and reconciliation process.

In connection with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, the Company will document and test its systems of internal controls for financial reporting in order to provide the basis for evaluation and report on these systems as of the end of its 2005 fiscal year. This documentation is in its early stages and will be effected as to scope and timing by the additional controls described above.

Part II. Other Information.

### **Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Annual Meeting of Stockholders of Ingles Markets, Incorporated was held Tuesday, February 17, 2004. Two matters were submitted to a vote of the stockholders at this meeting, (1) the election of nine directors to serve until the 2005 Annual Meeting of Stockholders and (2) the proposal to adopt the Qualified Transferee Amendment to the Articles of Incorporation of Ingles Markets, Incorporated. The voting results are as follows:

(1) The first matter submitted to a vote was the election of nine directors for the ensuing year.

Charles L. Gaither, Jr., John O. Pollard, and J. Alton Wingate were elected by the holders of Class A Common Stock by the following votes: (a) Mr. Gaither: 8,597,934 votes for, 1,337,752 votes withheld, 0 abstentions and 0 broker non-votes; (b) Mr. Pollard: 8,610,083 votes for, 1,325,603 withheld, 0 abstentions and 0 broker non-votes; (c) Mr. Wingate: 8,615,105 votes for, 1,320,581 votes withheld, 0 abstentions and 0 broker non-votes. Robert P. Ingle, Robert P. Ingle, II, James W. Lanning, Charles E. Russell, Laura Ingle Sharp and Brenda S. Tudor were each elected by the holders of Class B Common Stock by the following vote: 12,281,487 votes for, 1,200 votes withheld, 0 abstentions and 0 broker non-votes.

(2) The second matter submitted to a vote was the proposal to adopt the Qualified Transference Amendment to the Articles of Incorporation of Ingles Markets, Incorporated. The holders of Class A Common Stock and Class B Common Stock voting together, with the holders of Class B Common Stock being entitled to ten votes per share, approved the matter by votes of 127,417,606 for, 1,621,550 against, 58,122 abstentions and 3,665,778 broker non-votes. The holders of Class B Common Stock, voting as a separate class, approved the matter by votes of 12,281,487 for and 1,250 abstentions.

### **Item 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits.

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- 1) Exhibit 31.1 Rule 13a-14(a) Certificate
  - 2) Exhibit 31.2 Rule 13a-14(a) Certificate
  - 3) Exhibit 32.1 Certification Pursuant to 18 U.S.C. Section 1350
  - 4) Exhibit 32.2 Certification Pursuant to 18 U.S.C. Section 1350
- (b) The Company filed a Form 8-K on January 26, 2004, furnishing a press release announcing earnings for the first quarter of fiscal 2004.

The Company filed a Form 8-K on January 28, 2004, furnishing additional financial information for the first quarter of fiscal 2004. This additional information was disclosed during an earnings call.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Form 10-Q/A to be signed on its behalf by the undersigned thereunto duly authorized.

INGLES MARKETS, INCORPORATED

Date: February 10, 2005

/s/ Robert P. Ingle

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Robert P. Ingle  
Chief Executive Officer

Date: February 10, 2005

/s/ Brenda S. Tudor

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Brenda S. Tudor  
Vice President-Finance and Chief Financial Officer